

Audit Report



ABNORMAL GENERAL LEDGER ACCOUNT BALANCES FOR OTHER DEFENSE ORGANIZATIONS REPORTED BY DFAS CLEVELAND

Report No. D-2001-049

February 13, 2001

Office of the Inspector General
Department of Defense

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<p>Abstract Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, requires DoD and other Government agencies to prepare annual audited financial statements. This report is the second in a series of reports supporting our audit of the FY 2000 financial statements for "Other Defense Organizations-General Funds." That entity represents a consolidation of financial information from various Defense organizations and funds that use the Treasury Index 97 symbol. This report addresses the process used by the Defense Finance and Accounting Service (DFAS) Cleveland to report financial information for Other Defense Organizations. DFAS Cleveland reported \$924.9 million of abnormal general ledgers account balances for Other Defense Organizations at the end of FY 1999. </p>		
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Acronyms

DFAS	Defense Finance and Accounting Service
STARS-HCM	Standard Accounting and Reporting System-Headquarters Claimant Module



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2885

February 13, 2001

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Abnormal General Ledger Account Balances for
Other Defense Organizations Reported by DFAS Cleveland
(Report No. D-2001-049)

We are providing this report for review and comment. We conducted the audit in support of our audit of FY 2000 DoD Agency-Wide Financial Statements as required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Managers Act of 1994.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Finance and Accounting Service did not provide comments to the draft report. Therefore, we request that the Director, Defense Finance and Accounting Service provide comments to the final report by March 15, 2001.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Marvin L. Peek at (703) 604-9587 (DSN 664-9587) (mpeek@dodig.osd.mil) or Mr. Hoa H. Pham (703) 604-9588 (DSN 664-9588) (hpham@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma
David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2001-049
(Project No. D2000FA-0146.001)

February 13, 2001

Abnormal General Ledger Account Balances for Other Defense Organizations Reported by DFAS Cleveland

Executive Summary

Introduction. Public Law 101-576, the “Chief Financial Officers Act of 1990,” November 15, 1990, as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” October 13, 1994, requires DoD and other Government agencies to prepare annual audited financial statements. This report is the second in a series of reports supporting our audit of the FY 2000 financial statements for “Other Defense Organizations-General Funds.” That entity represents a consolidation of financial information from various Defense organizations and funds that use the Treasury Index 97 symbol. This report addresses the process used by the Defense Finance and Accounting Service (DFAS) Cleveland to report financial information for Other Defense Organizations. DFAS Cleveland reported \$924.9 million of abnormal general ledgers account balances for Other Defense Organizations at the end of FY 1999.

Objectives. The overall audit objective was to determine the accuracy and completeness of the data that DFAS Cleveland submitted to DFAS Center for Sustaining Forces-Indianapolis for inclusion in the financial statements for the Other Defense Organizations. Specifically, we concentrated on the causes of abnormal balances in the general ledger accounts. We also reviewed the DFAS Cleveland management control program as it related to our audit objective.

Results. Improvements were needed in promptly reconciling undistributed disbursements, recording liabilities in the accounting system, and properly preparing and documenting journal vouchers. Specifically:

DFAS Cleveland reported \$711 million of abnormal balances in the March 31, 2000, trial balance for the Other Defense Organizations. Of the \$711 million, \$645.5 million, or more than 90 percent, was related to general ledger account 2111 (Accounts Payable). As a result, the accounts payable reported in the consolidated trial balance for the Other Defense Organizations was not accurate and the reported expenses for the accounting period were not reliable (finding A).

DFAS Cleveland did not have complete documentation for the 81 on-line accounting adjustment transactions made to correct the abnormal balance for general ledger account, 2111 (Accounts Payable) valued at \$495 million. As a result, the usefulness of the reconciliation process for proper distribution of erroneous disbursements was

reduced, and errors in adjustment amounts may go undetected. Also, the reliability of future financial statements will continue to be affected until the problems identified are corrected (finding B).

Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service Cleveland:

- establish and implement policies and procedures to perform monthly reconciliation of undistributed disbursements,
- modify or reprogram the Standard Accounting and Reporting System- Headquarters Claimant Module to allow the system to show general ledger account balances for prior periods, and
- prepare journal vouchers in accordance with DoD and DFAS guidance for all correcting accounting entries and coordinate adjustments with affected organizations.

Management Comments. The draft report was issued on October 30, 2000, and we received no management comments. We request that the Director, Defense Finance and Accounting Service, respond to the final report by March 15, 2001.

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Background

Other Defense Organizations. Public Law 101-576, the “Chief Financial Officers Act of 1990,” November 15, 1990, as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” October 13, 1994, requires DoD and other Government agencies to prepare annual audited financial statements. The Inspector General, DoD, is responsible for auditing DoD-wide financial statements. The DoD Agency-Wide financial statements include a reporting entity entitled “Other Defense Organizations-General Funds.” The Other Defense Organizations represents a consolidation of financial information from various Defense organizations and funds that use the Treasury Index Symbol 97. During FY 1999, the Other Defense Organizations-General Funds reported \$42 billion in assets, \$201.8 billion in liabilities, and \$58.1 billion in budget authority. This is the second in a series of reports on the accuracy of data submitted in support of the FY 2000 financial statements for Other Defense Organizations-General Funds. This report discusses the reliability and effectiveness of policies and procedures used to report financial information for the Other Defense Organizations-General Funds by the Defense Finance and Accounting Service (DFAS) Cleveland.

Undistributed Disbursements. Undistributed disbursements occur because disbursing agents in the DoD and other Federal agencies disburse funds and report these disbursements directly to the Department of the Treasury in the month of disbursal. However, accounting offices responsible for recording the disbursements into the general ledger accounts do not receive the cash disbursement information until a later date. When the accounting office receives the cash disbursement information, the information may not contain all necessary data for the accounting offices to properly distribute to the fiscal stations responsible for the disbursements. Accordingly, this often creates a situation where the Department of the Treasury and the accounting offices’ general ledger accounts for disbursements are not equal. The difference is referred to as undistributed disbursements. To properly account for the discrepancies, the accounting office should perform a monthly reconciliation of undistributed disbursements.

Abnormal Balances Reported in the FY 1999 Year-end Trial Balances for the Other Defense Organizations. Inspector General, DoD, Report No. D-2000-153, “Compilation of the FY 1999 Financial Statements for Other Defense Organizations-General Funds,” June 23, 2000, states that during FY 1999, 11 accounting offices submitted year-end trial balances containing \$3.4 billion of abnormal balances. Of the \$3.4 billion of abnormal balances reported in the year-end trial balances, the DFAS Cleveland reported \$924.9 million.

Objectives

The audit objective was to determine the accuracy and completeness of the data submitted by DFAS Cleveland to DFAS Indianapolis for inclusion in the financial statements for the Other Defense Organizations. Specifically, we concentrated on the causes of abnormal balances in the general ledger accounts. We also reviewed the DFAS Cleveland management control program as it related to our audit objective. Appendix A discusses the audit scope and methodology and our review of the management control program.

A. Reporting and Disclosing Abnormal Balances

The DFAS Cleveland reported \$711 million of abnormal balances in the March 31, 2000, trial balance for the Other Defense Organizations. Of the \$711 million, \$645.4 million or more than 90 percent were related to general ledger account 2111 (Accounts Payable). The abnormal balance occurred because the DFAS Cleveland had not established and implemented procedures to adequately research and resolve undistributed disbursements for proper disposition. Abnormal balances in accounts payable occurred because:

- the Standard Accounting and Reporting System-Headquarters Claimant Module (STARS-HCM) was not designed to process a payable transaction. Accordingly, the accounts payable would become abnormal when the DFAS Cleveland tried to liquidate accounts payable that had not been established or to transfer undistributed disbursements to accounts payable as required by DoD guidance¹, and
- the STARS-HCM could not produce a monthly trial balance for the previous month because the module was not designed to show a snapshot of each general ledger account balance. Accordingly, this limitation hindered the reconciliation process.

As a result, the accounts payable reported in the consolidated trial balance for the Other Defense Organizations was not accurate and the related expenses were not reliable in the accounting period incurred.

Reconciliation Guidance

Office of Management and Budget Guidance. Statement of Federal Financial Accounting Standards No.1, “Accounting for Selected Assets and Liabilities,” March 30, 1993, requires Federal entities to reconcile undistributed disbursements due to time lags, and correct undistributed disbursements due to errors.

DoD Guidance. DoD Regulation 7000.14-R, “Financial Management Regulation,” volume 6A, chapter 2, January 1999 requires DFAS to establish procedures to investigate unreconciled differences and document all appropriate

¹ DoD Regulation 7000.14-R, volume 11B, chapter 54, states that the undistributed disbursement account is used to record the disbursements reported by the financial network which cannot be identified to a specific organizational level or transaction. Amounts recorded in this account shall be researched for proper disposition, by the lowest organizational level to which they can be distributed. Prior to financial report preparation, the remaining value in this account shall be transferred to account payable.

adjustments to balance the general ledger amount with the amount of the subsidiary records. The guidance further requires DFAS to perform the reconciliation on a monthly basis in order to determine the cause of the differences. DFAS is also required to take appropriate actions to ensure the accuracy and integrity of the accounting system and monthly reports when unreconcilable differences between the general ledger and the subsidiary ledger records exceed \$1 million.

Abnormal Balances Reported by DFAS Cleveland

Abnormal Balances. An account balance is abnormal when the reported balance does not comply with the normal debit or credit balance established in the general ledger chart of accounts. For example, Accounts Payable normally has a credit balance; therefore, a debit balance is an abnormal balance. Abnormal balances require explanation and reconciliation because if uncorrected, they will distort the accuracy of financial information reported for an entity. As of March 31, 2000, the quarterly trial balances prepared by DFAS Cleveland for the Other Defense Organizations reported \$711 million of abnormal balances in seven general ledger accounts as shown in the table below.

Abnormal Balances Reported by DFAS Cleveland for Other Defense Organizations	
<u>General Ledger Account</u>	<u>Amount</u>
1311 - Accounts Receivable	\$ 244,375
2111 - Accounts Payable	645,483,782
3100 - Appropriated Capital	928,527
5200 - Revenue From Services Provided	32,060,228
5700 - Appropriated Capital Used	161,309
6100 - Other Services	161,309
6500 - Cost of Goods Sold	32,060,229
Total	\$ 711,099,759

Corrections Made by DFAS Cleveland and DFAS San Diego. The DFAS Cleveland had not established procedures to perform a monthly reconciliation to determine specific causes of the reported undistributed disbursements. However, during the audit, the DFAS Cleveland and DFAS San Diego accounting personnel performed special research of undistributed disbursements/collections for appropriation 0400, Research, Development, Test, and Evaluation, and appropriation 0510, DoD Base Realignment and Closure Account. DFAS Cleveland selected appropriation 0400 for review because it noticed that undistributed disbursements at the departmental level increased by more than \$300 million in May 2000. Based on the results of the research, accounting personnel concluded that because of a computer programming error, \$495.0 million of undistributed disbursements were erroneously posted to the departmental general ledger accounts. Therefore, they reduced the departmental

undistributed disbursements by \$495.0 million. Accordingly, the abnormal balance for general ledger account 2111 (Accounts Payable) was reduced by the same amount. The accuracy and completeness of the adjustment is discussed in finding B of this report.

In addition, DFAS Cleveland and DFAS San Diego accounting personnel reduced abnormal balances reported for appropriation 0510, general ledger account 5200 (Revenue from Services Provided) and general ledger account 6500 (Cost of Goods Sold) by \$64 million because DFAS San Diego erroneously reported negative collections to the Centralized Expenditure Reimbursement Processing System. However, DFAS Cleveland and DFAS San Diego did not have complete audit trails for the above adjustments.

Reasons for Reporting Abnormal Balances

The lack of established procedures to adequately research and resolve undistributed disbursements for proper disposition was the primary cause of abnormal balances. Also, the limitations of the STARS-HCM in the recording of accounts payable and the retrieval of prior month trial balances contributed to the continued reporting of abnormal balances in accounts payable.

Compliance with Reconciliation Guidance. DoD Regulation 7000.14-R, "Financial Management Regulation," volume 11B, chapter 54, December 1994, requires that all undistributed disbursements must be researched for proper disposition by the lowest organizational level to which they can be distributed. As of March 31, 2000, the undistributed disbursements reported for the seventeen appropriations for Other Defense Organizations had an absolute value of \$1.46 billion. However, DFAS Cleveland had not established procedures to perform monthly reconciliation to determine specific causes of the reported undistributed disbursements. According to DFAS Cleveland accounting personnel, the monthly reconciliation of undistributed disbursements and collections for Treasury Index 97 were not performed because DFAS Cleveland was in the process of developing corrective actions and procedures to adequately reconcile undistributed disbursements and collections. Also, the DFAS Cleveland would need additional resources to adequately perform the research when reconciliation procedures were fully developed.

Adjustments to Accounts Payable. To comply with DoD Regulation 7000.14-R, volume 11B, chapter 54, December 1994, DFAS Cleveland programmed its departmental accounting system to adjust its accounts payable by the amount of undistributed disbursements prior to preparing financial reports. Accordingly, if accounts payable were less than the amount of undistributed disbursements, accounts payable would show a debit balance.

System Limitations. The Navy organizations using the STARS-HCM could not process a payable transaction and could not retrieve a prior month trial balance because the system was not designed to perform the above functions. As a result, accounts payable would have a debit, or abnormal balance when DFAS

Cleveland tried to liquidate an organization's liabilities that had not been recorded, or to transfer unreconcilable undistributed disbursements to accounts payable prior to preparing financial reports as required by DoD guidance.

Recording Accounts Payable. Naval Audit Service, Report No. N2000-0031, "Department of the Navy Principal Statements for Fiscal Year 1999: Accounts Payable Reporting Process," July 28, 2000, states that the Navy organizations did not record all FY 1999 accounts payable transactions. Specifically, organizations using the STARS-HCM could not record accounts payable since the module was not designed to process a payable transaction. The report recommended that the Navy accrue and report all liabilities to accounts payable. DFAS Cleveland accounting officials told us that DFAS Cleveland was in the process of converting all the Navy general ledger accounts to the U.S. Standard General Ledger during FY 2001, and when completed, STARS-HCM will be able to accrue all liabilities.

Because the Naval Audit Service made recommendations to correct the deficiencies in accruing and reporting accounts payable in Report No. N2000-0031, and DFAS was in the process of modifying STARS-HCM, we are not making any additional recommendations to correct the deficiencies noted.

Retrieving Prior Month Trial Balances and Producing Subsidiary Ledger. STARS-HCM was not able to retrieve a prior month trial balance for each general ledger account. Also, it was unable to produce a subsidiary ledger to support the reported accounts payable.

We judgmentally selected and requested supporting documentation and subsidiary ledgers for \$495.0 million of the \$645.5 million of abnormal balance in accounts payable reported in the March 31, 2000, trial balance. However, the reported accounts payable could not be verified because STARS-HCM was not designed to show a snap shot for each general ledger balance and was not able to produce an accounts payable subsidiary ledger that provided detailed information on the account. This problem was identified in Naval Audit Service Report No. 0006-98, dated November 14, 1997. DFAS concurred with the recommendation and issued a System Change Request on July 7, 1997; however, this problem remained unsolved at the time of our audit. As a result, DFAS Cleveland could not effectively reconcile the amount of accounts payable reported in the trial balances to the supporting subsidiary records.

Recommendations

A. We recommend that the Director, Defense Finance and Accounting Service Cleveland:

1. Establish and implement policies and procedures to reconcile, research, and resolve all undistributed disbursements.

2. Coordinate and establish a reconciliation schedule with major claimants to reconcile the subsidiary records with the financial balance.

3. Modify or reprogram the Standard Accounting and Reporting System-Headquarters Claimant Module to allow the system to show general ledger account balances for prior periods.

Management Comments Required

The Director, DFAS, did not provide comments to a draft of this report. We request that the Director provide comments on the final report.

B. Support for Accounting Adjustments

The DFAS Cleveland did not have complete documentation for the 81 on-line accounting adjustment transactions totaling \$495.0 million to correct the abnormal balance for general ledger account, 2111 (Accounts Payable). Adequate support for the accounting adjustments was lacking because the DFAS Cleveland had not established management controls to verify that:

- the process used to identify, correct, and adjust the balances to the official accounting records was thoroughly documented,
- proposed adjustments were adequately coordinated and approved by the affected Navy organizations before the adjustment transactions were entered into the accounting systems, and
- key duties and responsibilities in preparing, reviewing, and approving accounting adjustment transactions were separated among individuals.

As a result, the usefulness of the reconciliation process for proper distribution of erroneous disbursements reported by the accounting system was reduced and errors in adjustment amounts may go undetected. Also, the reliability of future financial statements will continue to be affected until the problems identified are corrected.

Criteria and Responsibilities

Reportable Conditions. The American Institute of Certified Public Accountants Statement on Auditing Standards No. 60, “Communication of Internal Control,” states that reportable conditions represent significant deficiencies in the design or operation of internal control that could adversely affect the organization’s ability to record, process, summarize, and report financial data. For example, absence of appropriate segregation of duties, and absence of appropriate reviews and approvals of transactions, accounting entries, or systems output are considered to be reportable conditions.

DoD Guidance. DoD Regulation 7000.14-R, volume 6A, chapter 2, “Departmental Financial Reports Roles and Responsibilities,” January 1998, requires DFAS to identify the requirement for adjustments to financial data. Also, the guidance requires DFAS to maintain sufficient supporting documentation for each adjustment. The supporting documentation shall include:

- the rationale and justification for the adjustment,

- the detail numbers and dollar amounts of errors or conditions that are related to the transactions or records that are proposed for adjustment,
- the date of the adjustment, and
- the name and position of the individual approving the adjustment.

DFAS Guidance. On August 2, 2000, DFAS issued guidance to implement the recommendation made by Inspector General, DoD, Report No. D-2000-160, "Compilation of the FY 1999 Army General Fund Financial Statements at the Defense Finance and Accounting Service Indianapolis Center," July 12, 2000. The guidance provides instructions on how the DFAS Centers and its Operating Locations should maintain supporting documentation for 10 different categories of correcting journal vouchers. Also, the guidance requires DFAS to have internal controls in place requiring that all journal vouchers be:

- sequentially numbered,
- identified by specific categories,
- reviewed to ensure proper recording,
- documented to support the validity and the amount of the journal voucher,
- authorized and approved by the appropriate authority, and
- annotated with name of both the preparer and the approver.

Controls Over Adjustments to the General Ledger

Internal controls over preparation, documentation, review, and approval of accounting adjustment transactions need to be strengthened.

Adjustments Made to the Accounting Records. DFAS Cleveland made 81 on-line accounting adjustment transactions to the Navy general ledger account, 1922 (Undistributed Disbursements) valued at \$495 million during the second quarter of FY 2000 to reclassify/distribute the departmental undistributed disbursements to other Navy organizations for proper research and correction of the undistributed amounts. The \$495 million were previously posted to the departmental general ledger account due to a computer posting error. Also, this reclassification affected the abnormal balance of accounts payable by the corresponding amount because DoD guidance requires the remaining balance of undistributed disbursements be transferred to the general ledger account, 2111 (Accounts Payable) prior to the preparation of the financial report. The adjustments were necessary because they were to correct accounting entry errors.

Review of Adjustments. Review of the 81 adjustments showed that the DFAS Cleveland did not prepare journal vouchers or the narrative explaining the reason for the adjustments. Supporting documentation consisted of computer printouts listing the dollar amounts and limits reported for the unidentified and identified major claimants. Also, supporting documentation did not explain where the information came from, how it was computed, what the accounting logic was used to support the amount of adjustment for each transaction, and who the preparer and the approver of the adjustment transactions were.

Although the adjustments were needed to correct accounting entry errors, DFAS Cleveland personnel did not prepare journal vouchers because they did not think journal vouchers were needed. Failure to prepare adjustment journal vouchers resulted in a lack of an audit trial. Accordingly, DFAS Cleveland should establish procedures to ensure that accounting adjustments are properly prepared, fully documented and supported. Also, adjustment journal vouchers should include all supporting documentation so that it can stand alone, without requiring additional explanation.

Notifying and Obtaining Approval from Affected Navy Organizations of Adjustments Made to the General Ledger. DFAS Cleveland adjusted official accounting records without notifying the affected Navy organizations, as required by DoD Regulation 7000.14-R, volume 6, chapter 2, January 1999, which states that DFAS is to identify the requirement for adjustments to the financial data. The regulation also specifies six exceptions that allow DFAS to make adjustments without the prior approval of the affected organizations. None of these exceptions were pertinent to the \$495 million adjustment.

DFAS Cleveland made adjustments to reclassify and distribute the departmental undistributed disbursements to appropriate major claimants so that the organizations could research and make corrections to the undistributed amounts. Therefore, DFAS Cleveland should coordinate and obtain approval from affected Navy organizations for the adjustments made.

Separation of Duties. Office of Management and Budget Circular A-123, "Management Accountability and Control," June 21, 1995, and DoD Regulation 7000.14-R state that key duties and responsibilities in authorizing, processing, recording, and reviewing official transactions should be separated among individuals. Also, the manager should exercise appropriate oversight to verify that individuals do not exceed or abuse their assigned authorities. The technician who researched the need for making 81 on-line accounting adjustments was also the person who entered the correction into the accounting system. Also, there was no evidence that the 81 on-line accounting adjustments were reviewed and approved by appropriate officials. This occurred because DFAS Cleveland accounting personnel believed that adjustments to correct accounting entries, due to a computer posting error, did not require formal journal vouchers. As a result, adjustments were entered into the accounting system without prior review or approval by the supervisor. Also, the lack of separation of duty increases the probability of errors in adjustment amounts being undetected.

Recommendations

B. We recommend that the Director, Defense Finance and Accounting Service Cleveland:

1. Prepare journal vouchers in accordance with DoD and DFAS guidance for all correcting accounting entries.
2. Provide appropriate separation of duties and adequate supervision to increase the reliability and integrity of financial information.
3. Coordinate adjustments with affected Navy organizations to jointly determine the causes of the undistributed disbursements prior to recording the adjustments.

Management Comments Required

The Director, DFAS, did not provide comments to a draft of this report. We request that the Director provide comments on the final report.

Appendix A. Audit Process

Scope

We reviewed the procedures and controls used by DFAS Cleveland to prepare financial information for the Other Defense Organizations. Specifically, we reviewed \$559 million of the \$711 million of abnormal balances reported in the March 31, 2000 trial balance. We reviewed the reconciliation procedures and initiatives made by DFAS Cleveland to determine the causes of undistributed disbursements. Also, we reviewed the accuracy and the completeness of the adjustments made to reduce the abnormal balance of accounts payable.

DoD-Wide Corporate Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals and performance measures. This report pertains to achievement of the following goals and performance measures.

- **FY 2001 DoD Corporate Level Goal 2:** Prepare for now an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-2)**
- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5)**
- **FY 2001 Performance Measure 2.5.1:** Reduce the number of noncompliant accounting and finance systems. **(01-DoD-2.5.1)**
- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2.)**

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objectives and goals.

- **Financial Management Area. Objective:** Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. **(FM-5.3)**

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in the DoD. This report provides coverage of the Defense Financial Management high-risk area.

Methodology

We reviewed applicable laws, policies, procedures, and regulations related to the undistributed disbursements, the recording of liabilities, and the journal vouchers preparation. We judgmentally selected and reviewed supporting documentation and subsidiary ledgers for \$495.0 million of the \$645.5 million of abnormal balance in accounts payable and \$64 million of abnormal balances in appropriated capital used and cost of goods sold reported in the March 31, 2000, consolidated trial balance. We reviewed 81 on-line accounting adjustment transactions made to the Navy general ledger account, 1922 (Undistributed Disbursements) valued at \$495.0 million for enforcement of established internal controls over preparation, documentation, and accounting logic. We reviewed DFAS Cleveland accounting records, and held discussions with DFAS Cleveland and DFAS San Diego accounting and systems personnel responsible for compiling, reviewing, and correcting financial information reported in the consolidated trial balance.

Use of Computer-Processed Data. We relied on computer-processed data from STARS-Financial and Departmental Reporting, STARS-Field Level, and STARS-HCM to conduct the audit at DFAS Cleveland. We relied on computer-processed data without performing tests of the system's general and application controls because the process for reconciling undistributed disbursements and preparing journal vouchers is primarily a manual process. Not evaluating the controls did not affect the results of the audit.

Audit Type, Dates, and Standards. We performed this financial-related audit from April through August 2000 in accordance with the auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary.

Contact During the Audit. We visited and contacted individuals and organizations in DoD. Further details are available on request.

Management Control Program Review

DoD Directive 5010.38, "Management (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the management controls.

Scope of the Review of the Management Control Program. We reviewed the adequacy of the DFAS Cleveland management controls over preparing and reporting financial information for the Other Defense Organizations. Also, we reviewed the controls over preparing and documenting journal vouchers. We reviewed management's self-evaluations applicable to those controls.

Adequacy of Management Controls. We identified material management control weaknesses at the DFAS Cleveland, as defined by DoD Instruction 5010.40. The DFAS is establishing policies and procedures to reconcile, research, and resolve undistributed disbursements and is also modifying STARS-HCM to show ledger account balances for prior periods. Also in August, 2000, the DFAS issued guidance covering preparation and use of journal vouchers. If DFAS Cleveland completes and implements procedures for reconciling undistributed disbursements, follows new guidance on preparation of journal vouchers, and implement the recommendations in this report, these management control weaknesses will be reduced.

Prior Coverage

The General Accounting Office and the Inspector General DoD have conducted multiple reviews related to the abnormal balance. General Accounting Office reports can be accessed on the Internet at <http://www.gao.gov>. Inspector General, DoD, reports can be accessed on the Internet at <http://www.dodig.osd.mil/audit/reports>.

Appendix B. Report Distribution

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Audit Team Members

This Report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD. Personnel of the Office of the Inspector General, DoD, who contributed to the report are listed below.

F. Jay Lane
Salvatore D. Guli
Marvin L. Peek
Hoa H. Pham
Modupe M. Akinsika
Brian S. Benner
Andrea L. Hill
Gopal K. Jain